

Presentation on Introduction to Accounting (Chapter-1)

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Scope of Study

Important IAS
(Certificate level- Accounting)

	The Conceptual Framework for Financial Reporting
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Reporting Period
IAS 16	Property, Plant and Equipment
IAS 33	Earnings Per Share
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IFRS 15	Revenue from Contracts with Customers

Accounting

Accounting is an art of **recording, analyze and summarizing** the **financial information** in a significant manner.

- Recording refers creating journal entry for all transactions with debit and credit.
- Analyzed & Classifying refers classifying all debit and credits into revenue/ capital nature along with Assets, Liabilities, Income, expenses.
- Summarizing refers summarize all financial information into Financial Statements

User of Accounting Information

- Investors
- Employees
- Lenders
- Supplier and other creditors
- Customers and their agencies
- Public

- ✓ **An entity's transactions are recorded first in**
 - a) Books of original entry
 - b) Ledgers accounts
 - c) The income statement
 - d) The statement of financial position.



International Financial Reporting Standards (IFRSs) : Standards and Interpretations issued by the International Accounting Standards Board (IASB). They comprise:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards;
- (c) IFRIC Interpretations; and
- (d) SIC Interpretations.

IAS are standards issued by the IASC from 1973 to 2001 that dictate how events and transactions should reflect on a company's financial statements.

IFRS is the current and updated version of the IAS and is issued by a new standard making body, the IASB.

So how is IAS and IFRS different? Well, technically they are the same. IFRS is the current set of standards that is reflective of the changes in the accounting and business practices over the last two decades. IAS is what used to be prior to the introduction of IFRS. However, not all of the IAS are outdated. In fact, to date there are only 17 IFRS issued and the IAS that were not superseded by the IFRS are still in use. The IASB no longer issues IAS. Any future standards will now be called IFRS, and if they are contradictory to existing IAS, the IFRS will be followed.

Objective of Financial Statements

- To provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making **economic decisions**.

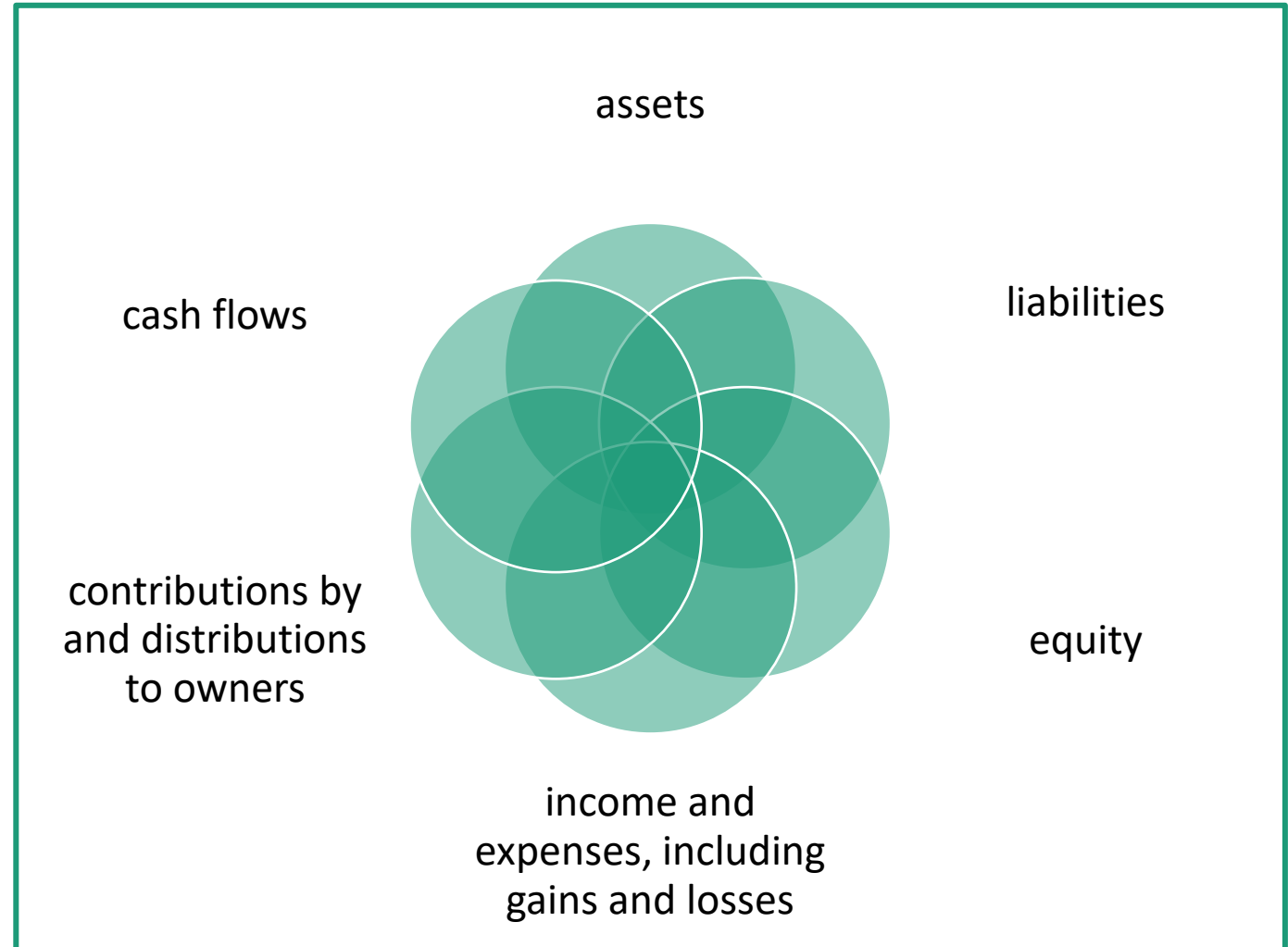


- ✓ Which one of the following issues in an entity's financial statements is likely to be of most interest to an entity's lender?
- a) Whether the entity has paid a dividend
 - b) Whether the entity will repay a loan when it falls due
 - c) Whether the entity will continue to be able to employ people
 - d) Whether the entity patronizes local suppliers.

Objective of Financial Statements

To meet that objective, financial statements provide information about an entity's:

That information, along with other information in the notes, show the result of **management stewardship** of the resources entrusted to it assists users of financial statements in **predicting the entity's future cash flows** and, in particular, their timing and certainty.



Components of Financial Statements

► A complete set of financial statements should include:

- 1) Statement of Financial Position "at the end of the period",
- 2) Single Statement of Profit or Loss and Other Comprehensive Income "for the period" (or two statements: Statement of Profit and Loss and Statement of Other Comprehensive Income),
- 3) Statement of changes in equity "for the period",
- 4) Statement of Cash Flows "for the period", and
- 5) Notes, comprising a summary of accounting policies and other explanatory notes

► An entity must also present a statement of financial position as at the **beginning** of the earliest comparative period when:

- an accounting policy is applied retrospectively; or
- items are restated retrospectively; or
- when items are reclassified



Regulation of Accounting

- **Legislation**
(The Companies Act 1994, BSEC regulation, The Bank Companies Act 1991, etc)
- **Accounting concepts & individual judgment**
(Valuation, brand value, reputation – judgement may vary)
- **Accounting Standards**
(IAS, IFRS)
- **Commonly used accounting practice**
(companies act, statutory requirement, listing rules)
- **True and fair view/ fair presentation**
(Fundamental QC: Relevance & Faithful presentation)

Departure from IASs

There may be (very rare) circumstances when management decides that compliance with a requirement of a IAS would be so misleading that financial statements would not meet their objectives.

Departure from the IAS may therefore be required to achieve a fair presentation. The following should be disclosed in such an event.

- ✓ **Management confirmation** that the financial statements fairly present the entity's financial position, performance and cash flows
- ✓ **Statement that all IASs have been complied** with except in respect of departure from individual IASs, required to achieve a fair presentation
- ✓ **Details of the nature of the departure**, why the IAS treatment would be misleading, and the treatment adopted
- ✓ **Financial effect of the departure**

IFAC code of ethics for Professional Accountants

IFAC is the global organization for the accounting professional. Its aims to ensure that the global accountancy profession is valued in the development of strong and sustainable organizations. The IFAC Code of Ethics for professional Accountants must adhere to. These are:

- **Integrity**---straightforward and honest
- **Objectivity**---not allow bias
- **Professional competency and due care**---maintain professional knowledge and behavior
- **Confidentiality**---Should respect confidentiality of information
- **Professional behaviour**---Should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Qualitative Characteristics of Financial Information

→ Fundamental QC:

- Relevance: making a decision made by users.
 - Predictive value: used to predict future outcome
 - Confirmatory value: provide feedback for previous evaluation
- Faithful representation will be
 - Complete: includes all information
 - Neutral : without bias
 - Free from errors : does not means the information is perfectly accurate in all respects.

→ Enhancing QC:

- Comparability: enable to identify similarities in & diff among items.
- Verifiability: Mgt can check it by examination, inspection and comparison.
- Timeliness: having information available to decision makers in time.
- Understandability : users who have a reasonable knowledge of business and economic activities.

Capital and Revenue Expenditure

Capital Expenditure

Expenditure which results in the acquisition of long term assets, or an improvement or enhancement of their earning capacity.

- **Examples:**

- Land & Building
- Machinery & Equipment
- Advance, prepayments etc

Revenue Expenditure

Expenditure which is incurred either for trading purpose or to maintain the existing earning capacity of long term assets.

Examples:

- Salary expenses
- Rent
- Electricity
- Depreciation

Capital and Revenue Income

Capital

From sale of non- current assets.

Revenue

- Sale of trading assets
- Services
- Interest & dividend from business investment

Materiality

Omissions or misstatements of items are material if they could, individually or collectively, **influence the economic decisions** of users taken on the basis of the financial statements.

Materiality depends on the size and nature of the omission or misstatements judged in the surrounding circumstances.

✓ **Which of the following factors have not influenced financial reporting?**

- a) National legislation
- b) Economic factors
- c) International Accounting standards
- d) GAAP

✓ **Materiality is an entity-specific aspect of which qualitative characteristic?**

- a) Relevance
- b) Understandability
- c) Faithful representation
- d) Comparability

✓ **Which of the following is an item of capital expenditure?**

- a) Cost of goods sold
- b) Purchase of a machine
- c) Repairs to a machine
- d) Wages cost

Going Concern

An entity preparing IFRS financial statements is presumed to be a going concern. The entity is viewed as continuing the operation in the foreseeable future. It is assumed that the entity has neither the intention nor the necessity of liquidation or ceasing to trade.

Problem: A retailer commences business on 1 January and buys 20 washing machines, each costing CU100. During the year he sells 17 machines at CU150 each. How should the remaining machines be valued at 31 December in the following circumstances?

- (a) He is forced to close down his business at the end of the year and the remaining machines will realise only CU60 each in a forced sale.
- (b) He intends to continue his business into the next year.

Sample answer:

- (a) If the business is to be closed down, the remaining three machines must be valued at the amount they will realise in a forced sale, i.e. $3 * CU60 = CU180$.
- (b) If the business is regarded as a going concern, the machines unsold at 31 December will be valued as an asset at cost, $3 * CU100 = CU300$.

Accrual Basis of Accounting

Items are recognised as assets, liabilities, equity, income and expenses when they satisfied the definitions and recognition for those elements in the conceptual framework.

Consistency of Presentation

The presentation and classification of items in the financial statements shall be **retained** from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS.

- Assets and liabilities, and income and expenses, must not be offset unless required or permitted by IFRS
- IAS 32 (Financial Instruments: Presentation) contains rules on the offset of financial assets and financial liabilities which require offset when (and only when) an entity:
 - has a legal right to set off; and
 - intends to settle on a net basis; or
 - to realise the asset and settle the liability simultaneously

Comparative Information

- If comparative amounts are **changed** or **reclassified**, various disclosures are required.
- IAS 1 requires that comparative information shall be disclosed in respect of the **previous period** for all amounts reported in the financial statements, both face of financial statements and notes, unless another Standard requires otherwise.

The business entity concept

A business as a separate entity, distinct from its owners or managers. The concept applies whether the business is limited liability company (and so recognized in law as a separate entity), a sole trader or a partnership (in which case the business is not legally recognized as a separate entity).

- ✓ Liability for the debts of the business **does not** fall on
 - a) A sole traders
 - b) Partner in a general partnership
 - c) A limited liability company
 - d) Owners of a limited liability company.

Historical cost concept

Transactions are recorded at their cost when they occurred. A basic principle of accounting is that the monetary amount at which items are normally measured in financial statements is at historical cost, ie at the amount which the business paid to acquire them.

✓ **Which of the following best explains what is meant by 'capital expenditure'?**

- a) A. On non-current asserts, including repairs and maintenance
- b) On expensive items over BDT 10,000
- c) On the acquisition of non-current assets, or improvement in their earning capacity
- d) On items relating to share capital

✓ **Which one of the following should be accounted for as capital expenditure?**

- a) The annual cost of painting a factory floor
- b) The repair of a window in a building
- c) The purchase of a vehicle by a garage for re-sale
- d) Legal fees incurred on the purchase of a building

✓ **Which of the following items should be treated as capital expenditure in the accounts of a sole trader?**

- a) BDT 5000 taken by the proprietor to buy himself a hi fi system
- b) BDT 4000 spent on purchasing a new PC to replace his secretary's old one.
- c) BDT 2000 on purchasing a machine for resale
- d) BDT 1500 paid to a painter for redecorating his office.

Statement of Financial Position

Current assets

- are cash; cash equivalent; assets held for collection, sale, or consumption within the entity's normal operating cycle; or assets held for trading within the next 12 months. All other assets are non-current.

Current liabilities

- are those to be settled within the entity's normal operating cycle or due within 12 months, or those held for trading, or those for which the entity does NOT have an unconditional right to defer payment beyond 12 months. Other liabilities are non-current.

✓ **A statement of financial position is best described as :**

- a) A snapshot of the entity's financial position at a particular point in time.
- b) A record of an entity's financial performance over a period of time
- c) A list of all the income and expenses of the entity at a particular point in time
- d) A list of all the assets and liabilities of the entity over a period of time.

✓ **In applying fundamental accounting concepts the preparers of financial information are also using**

- a) Legislation
- b) Accounting standards
- c) Judgement
- d) Financial reporting standards.

✓ **Which of the following is not a source of the accounting rules embodied in a GAAP?**

- a) The Companies Acts
- b) Commonly used accounting practices
- c) Listing requirements of Dhaka Stock Exchange
- d) Accounting requirements of an entity's US parent company

Statement of Profit or Loss and other Comprehensive Income

Revenue
Expenses
Share of profit of associate
Profit before tax
Income tax expense
Profit from continuing ops
Loss from discontinued ops
PROFIT FOR THE YEAR
Other comprehensive income:
AFS assets
Revaluation
OCI before tax
Tax relating to OCI
OCI after tax
TOTAL COMPREHENSIVE INCOME

X
(X)
X
X
(X)
X
(X)
X

X
(X)
X
(X)
X
X

May be two separate
statements

Statement of Changes in Equity

Details the movement in owners' equity over a period. The movement in owners' equity is derived from the following components:

- Net Profit or loss during the period as reported in the income statement
- Share capital issued or repaid during the period
- Dividend payments
- Gains or losses recognized directly in equity (e.g. revaluation surpluses)
- Effects of a change in accounting policy or correction of accounting error.

Statement of Cash Flows

Presents the movement in cash and bank balances over a period. The movement in cash flows is classified into the following segments:

Operating Activities: Represents the cash flow from primary activities of a business.

Investing Activities: Represents cash flow from the purchase and sale of assets other than inventories (e.g. purchase of a factory plant)

Financing Activities: Represents cash flow generated or spent on raising and repaying share capital and debt together with the payments of interest and dividends.

✓ **According to the IASB's Framework for the Preparation and Presentation of Financial Statements, for information to be useful in the financial statements it must have which of the following qualities?**

- a) Comparability, understandability, relevance, reliability
- b) Consistency, prudence, measurability, relevance
- c) Consistency, reliability, measurability, relevance
- d) Materiality, comparability, measurability, reliability.

✓ **Which THREE of the following users of financial statements are likely to be interested in the financial statements of a small private company?**

- a) Stock market analysis
- b) Company employees
- c) The company's bank
- d) Suppliers.

Case-1: Capital or revenue?

State whether each of the following items should be classified as '**capital**' or '**revenue**' expenditure or income.

- (a) The purchase of a property (e.g. an office building)
- (b) Property depreciation
- (c) Solicitors' fees in connection with the purchase of property
- (d) The costs of adding extra memory to a computer
- (e) Computer repairs and maintenance costs
- (f) Profit on the sale of an office building
- (g) Revenue from sales by credit card
- (h) The cost of new machinery
- (i) Customs duty charged on machinery when imported into the country
- (j) The 'carriage' costs of transporting the new machinery from the supplier's factory to the premises of the business purchasing it
- (k) The cost of installing the new machinery in the premises of the business
- (l) The wages of the machine operators

Sample answer

- (a) Capital expenditure
- (b) Depreciation is revenue expenditure
- (c) Legal fees associated with purchasing a property may be added to the purchase price and classified as capital expenditure
- (d) Capital expenditure (enhancing an existing long-term asset)
- (e) Revenue expenditure (restoring an existing long-term asset)
- (f) Capital income (net of the costs of sale)
- (g) Revenue income
- (h) Capital expenditure
- (i) If customs duties are borne by the purchaser of the long-term asset, they should be added to the purchase cost of the machinery and classified as capital expenditure
- (j) If carriage costs are paid for by the purchaser of the long-term asset, they should be included in the cost of the long-term asset and classified as capital expenditure
- (k) Installation fees of a long-term asset are also added to cost and classified as capital expenditure
- (l) Revenue expenditure

- ✓ **Which TWO of the following information needs apply to the government and its agencies in relation to the business of a sole trader?**

The government and its agencies need information to

- a) Establish level of tax revenue
- b) Assess whether the business will continue in existence
- c) Produce national statistics
- d) Assess the owner's stewardship
- e) Take decisions about their investment.

- ✓ **According to IAS 1 which of the following does not represent an objective of financial statements?**

- a) To provide information to investors in making economic decisions
- b) To provide information to managers in making business decisions
- c) To show the result of management's stewardship of the resources entrusted to it
- d) To help users predict the entity's future cash flows

*Thank
you*

